EXERCISE 5



The European Central Bank (ECB) and the central bank of Bosnia-Herzegovina decided in the past to link their currencies to one another.

What is the name of this type of currency system?

_____

Both central banks decide on a _____ of 1 BAM = 0,50 EUR. (BAM = Bosnian Mark)

Suppose a _____of +/- 10% was set.

This means that the _____ equals 1 BAM = 0,55 EUR and that the _____ equals 1 BAM = 0,45 EUR.

Draw a correct and complete graph with the data above:

We will examine a scenario in which the BAM comes under pressure and decreases in value against the EUR (e.g. an exchange rate of 1 BAM = 0.35 EUR), for example because inflation in Bosnia and Herzegovina is extremely _____ (high/low). This means that the demand for BAM _____ (increases/decreases) and/or the supply of BAM _____ (increases/decreases).

The central bank of Bosnia-Herzegovina must intervene *(ingrijpen)*.

What measure will it take?

_____

Explain this intervention:

_____

_____

Suppose the intervention is unsuccessful and the BAM/EUR exchange rate falls further. In that case, the central banks of both countries will have to sit down together and take an even more drastic measure.

What measure will they take?

_____

Explain this intervention:

_____

_____

Mark this intervention on the graph (see above).

Write-down 1 advantage and 1 disadvantage of this type of currency system:

Advantage	Disadvantage